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Message Text

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ACTION EUR-12

INFO OCT-01 ISO-00 AID-05 CEA-01 CIAE-00 COME-00 EB-08
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SP-02 TRSE-00 LAB-04 SIL-01 AGRE-00 OMB-01 SS-15
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USEEC ALSO FOR EMBASSY

PASS TREASURY FOR WIDMAN, FRB FOR GOVERNOR WALLICH,
CEA FOR CHAIRMAN SCHULTZE AND SHAFER

E.O. 11652: N/A
TAGS: OECD, ECON
SUBJECT: ECONOMIC POLICY COMMITTEE (EPC): MAIN ISSUES
(CPE(78)7 AND SCENARIO

REF: A) PARIS 7999, B) CPE(78)7

1. SUMMARY. ADVANCE COPY OF MAIN ISSUES PAPER FOR
MAY 29-30 EPC INDICATES THAT SECRETARIAT HAS ELABORATED
ON AND GIVEN SPECIFICITY TO "CONCERTED ACTION" STRATEGY
ADOPTED BY FEB EPC. PAPER AND SUPPORTING DOCUMENTS
ASSIGN SPECIFIC ROLES TO COUNTRIES AND GROUP OF
COUNTRIES AS REQUESTED BY SOME DELEGATIONS
AT FEB EPC (SEE PARA 3 PARIS 7999), REQUIRING
DIFFERENTIATED STIMULUS TO DOMESTIC DEMAND DEPENDING
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ON COUNTRIES INTERNAL AND EXTERNAL BALANCE POSITION.
SECRETARIAT SUGGESTS EPC SHOULD REFRAIN FROM DISCUSSION
OF COUNTRY FORECASTS, IN FAVOR OF IN-DEPTH DISCUSSION
OF PROPOSED CONCERTED MACROECONOMIC STRATEGY AND ITS
PLACE IN BROADER CONCERTED ACTION PROGRAM TO BE PRESENTED
TO MINISTERS. EPC ESPECIALLY ASKED TO EVALUATE
SECRETARIAT ANALYSIS OF INFLATION AND INVESTMENT

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CONSTRAINTS IN CONTEXT OF PRESENTED POLICY ACTIONS.
SECRETARIAT (FAY) HAS MADE CLEAR THAT SPECIFICITY
OF EPC DOCUMENTATION IS FOR ILLUSTRATIVE PURPOSES AND
THAT ALTHOUGH IT WOULD BE MAINTAINED IN BACKGROUND
PAPERS FOR MINISTERIAL, IT WAS NOT INTENTION TO GO FOR
SPECIFIC COUNTRY OR AREA TARGETS IN MINISTERIAL
COMMUNIQUE OR ASSOCIATED DOCUMENTS.

2. MISSION HAS ACQUIRED ADVANCE COPY OF MAIN ISSUES
PAPER FOR MAY 29-30 MEETING OF EPC (FULL TEXT HAND
CARRIED TO EUR/RPE-GELBARD BY ALVIN ADAMS). PAPER
BRIEFLY REVIEWS CURRENT ECONOMIC SITUATION IN OECD
AREA, HIGHLIGHTING SLOW GROWTH, HIGH UNEMPLOYMENT,
UNSATISFACTORY INFLATION RATES AND WORSENING DISTRIBUTION
OF PAYMENTS IMBALANCES. SECRETARIAT DESCRIBES TIGHTLY
CONSTRAINED FIELD OF ACTION FOR GOVERNMENT POLICY SINCE
1) PERSISTENT INFLATION IS BECOMING INSTITUTIONALIZED
IN MANY COUNTRIES AND BEING BUILT AUTOMATICALLY INTO
WAGE CLAIMS; 2) PROTRACTED CURRENT ACCOUNT IMBALANCES
RESULT IN LOP-SIDED EXTERNAL DEBT POSITIONS;
3) STRUCTURAL PROBLEMS EXACERBATED BY SLOW GROWTH,
ARE FURTHER SLOWING GROWTH POTENTIAL; 4) ADJUSTMENT OF
TRADE FLOWS TO EXCHANGE RATE CHANGES IS COMPLEX AND
LENGTHY PROCESS. IN THESE CIRCUMSTANCES, SECRETARIAT
NOTES, FEW COUNTRIES HAVE ROOM TO MANEUVER AND IT IS
IMPERATIVE THAT THOSE WHO DO MAKE USE OF IT TO FULLEST
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POSSIBLE EXTENT.

3. FOLLOWING THIS INTRODUCTION, SECRETARIAT OUTLINES
PROPOSED CONCERTED GROWTH PROGRAM WHICH IT SEES AS
PART OF WIDER PACKAGE INCLUDING STRUCTURAL ADJUSTMENT,
ENERGY, NORTH/SOUTH, AND TRADE POLICIES TO BE
PRESENTED AT MINISTERIAL. (DRAFT BACKGROUND DOCUMENT
FOR MINISTERIAL WILL BE AVAILABLE FOR EPC DISCUSSION.)
CONCERTED PROGRAM IS BASICALLY ORIENTED TOWARD
DOMESTIC DEMAND MANAGEMENT (STIMULUS) WITH STRONG
ADMINITIONS THAT INFLATION RISKS MUST BE VERY
CAREFULLY CONSIDERED. SECRETARIAT ANALYSIS OF
INFLATION RISK CONCLUDES THAT ONE PERCENT FASTER GROWTH
IN OECD AREA (IF BROUGHT ABOUT BY PROGRAM
DESCRIBED BELOW) WOULD ADD ABOUT ONE-HALF POINT TO
AREA-WIDE INFLATION RATE. SECRETARIAT URGES THAT
STIMULATING POLICY MEASURES BE DESIGNED TO HAVE MINIMAL,
OR EVEN NEGATIVE, IMPACT ON PRICE LEVELS. PUBLIC
SECTOR DEFICITS WOULD ALSO BE SLIGHTLY LARGER (1/2 -
3/4 PERCENT OF GNP IN STRONG COUNTRIES - GERMANY,
JAPAN, SWITZERLAND.)

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4. CONCERTED PROGRAM INCLUDES ASSIGNED ROLE FOR EACH INDIVIDUAL COUNTRY, ALTHOUGH THEY ARE GROUPED BY COMMON CHARACTERISTICS. TARGET GROWTH RATES INDICATED WOULD BE REACHED DURING FIRST HALF OF 1979. IN BRIEF, ASSGNMENTS ARE:

-- COUNTRIES WITH LARGE CUMULATED BOP SURPLUSES AND LOW INFLATION WOULD TAKE ACTION "PRIMARILY" DESIGNED FOR FASTER GROWTH. TARGET GROWTH RATES: JAPAN 7-1/2 PERCENT; GERMANY 5 PERCENT; SWITZERLAND 4-1/2 PERCENT.

-- COUNTRIES WITHOUT BOP DIFFICULTIES AND INFLATION BELOW OECD AVERAGE. TARGETS: BELGIUM AND NETHERLANDS, 4-1/2 PERCENT.

-- COUNTRIES WITH RECENT IMPROVEMENTS ON BOP AND INFLATION. TARGETS: FRANCE, 5 PERCENT; ITALY, 4-1/4 PERCENT.

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-- COUNTRIES CONVALESCING BUT STILL CONSTRAINED BY BOP AND INFLATION. TARGETS (CALCULATED TO RESULT IN UNCHANGED BOP DEFICIT): CANADA, 4 PERCENT, U.K. 3 PERCENT.

-- ALL OTHERS - SHOULD TAKE NO STIMULATIVE MEASURES SINCE BOP AND INFLATION CONSTRAINTS ARE JUDGED TO TAKE PRIORITY. (MISSION NOTE - U.S. IS IMPLICITLY IN THIS CATEGORY).

5. GENRE OF A POLICY ACTION TO ACHIEVE THESE TARGETS ALSO OUTLINED BY SECRETARIAT AS FOLLOWS:

GERMANY - CUTS IN INCOME TAXES AND MEASURES TO STIMULATE CAPITAL WIDENING INVESTMENT.

JAPAN - SUBSTANTIAL PERSONAL INCOME TAX CUT MIGHT BE COMBINED WITH INCREASED PUBLIC TRANSFERS AND HIGHER GOVERNMENT INVESTMENT EXPENDITURE.

SWITZERLAND - ACCELERATION OF PUBLIC INVESTMENT TOGETHER WITH TAX CUTS TO ENCOURAGE CONSUMPTION.

BELGIUM AND THE NETHERLANDS - TAX REDUCTIONS

FRANCE - ARRANGEMENTS TO REDUCE FIRMS' SOCIAL INSURANCE COST COULD BE BROADENED AND MADE MORE PERMANENT AND INVESTMENT INCENTIVES INTRODUCED.

ITALY - SIMILAR MEASURES (AS FRANCE) COULD BE ENVISAGED BUT BUTTRESSED BY AGREEMENT BY THE TWO SIDES OF INDUSTRY TO REDUCE COSTS AND INCREASE PRODUCTIVITY.

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6. IN ADDITION TO DEMAND MANAGEMENT POLICIES, SECRETARIAT URGES SUPPORTING POLICY ACTION TO:

A) STIMULATE INVESTMENT - BY ACHIEVING REDUCTION IN RATE OF GROWTH OF WAGES TO HELP REDUCE INFLATION (THUS PERCEIVED RISKS AND UNCERTAINTY) AND RESTORE MORE NORMAL PROFIT SHARES.

B) CALM EXCHANGE MARKETS BY ASSURING THAT MIX OF MONETARY AND FISCAL POLICIES WILL ENCOURAGE EQUILIBRATING CAPITAL MOVEMENTS WHILE CONCERTED GROWTH PROGRAM SHOULD AUTOMATICALLY EASE MARKET DISTURBANCES BY IMPROVING DISTRIBUTION OF CURRENT ACCOUNT IMBALANCES.

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OFFICIAL INTERVENTION WOULD BE MORE EFFECTIVE IN
THESE CIRCUMSTANCES, ACCORDING TO SECRETARIAT.

C) ASSIST STRUCTURAL ADJUSTMENT - BY SHIFTING TO
POSITIVE ADJUSTMENT AND AWAY FROM DEFENSIVE, EFFICIENCY-
REDUCING POLICIES.

7. MAIN QUESTIONS: SECRETARIAT SUGGESTS THAT EPC
NOT UNDERTAKE DISCUSSIONS OF COUNTRY FORECASTS, BUT
FOCUS ON ISSUES OF RELEVANCE IN PREPARATION FOR THE
MINISTERIAL. EPC IS ASKED:

A) WHETHER IT SUPPORTS THE CONCEPT OF A BROAD
CONCERTED ACTION PROGRAM TO INCLUDE POLICY ACTION ON
ALL ELEMENTS NOTED PARA 2 ABOVE?

B) WHETHER IT SUPPORTS THE MACROECONOMIC CONCERTED
PROGRAM PER PARAS 3 - 5 AS INTEGRAL PART OF BROAD

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PROGRAM?

C) WHETHER IT AGREES WITH SECRETARIAT'S ANALYSES OF
INFLATION RISK, SEE PARA 2?

D) WHETHER IT AGREES THAT INVESTMENT RECOVERY WILL

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REQUIRE BOTH A PICK-UP IN DEMAND AND A RESTORATION OF PROFIT LEVELS, ALL ON THE ASSUMPTION THAT INFLATION RATES ARE BROUGHT DOWN?

8. TENTATIVE SCENARIO: SECRETARIAT PROPOSES THAT ALL FOUR MAIN QUESTIONS BE ADDRESSED AS A UNIT IN DISCUSSION WHICH WILL REQUIRE MAJORITY OF TWO-DAY SESSION. IN ACCORDANCE WITH CHAIRMAN SCHULTZE'S SUGGESTED NEW SCENARIO FOR EPC MEETINGS, SECRETARIAT WOULD PLAN TO DESIGNATE 5 KEYNOTE SPEAKERS (LIMITED TO 15 MINUTE INTERVENTIONS) TO OPEN DISCUSSION (TENTATIVELY JAPAN, GERMAN, NETHERLANDS, SWITZERLAND, U.S. IN THAT ORDER), THEN RESTRICTING SUBSEQUENT SUBSTANTIVE INTERVENTIONS TO 10 MINUTES, WITH PROVISION FOR ONE-
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MINUTE QUESTION OR STATEMENT AT ANY TIME BY ANY DELEGATE. CHAIRMAN WOULD GIVE "PROVOCATIVE SUMMARY" OF DISCUSSION TO OPEN SECOND DAY, FOLLOWED BY TWO COMMENTATORS (TENTATIVELY UK AND GERMANY); DISCUSSION OF SUMMARY WOULD BE CUT OFF AT 11:30 A.M. (SUMMARY AND DISCUSSION SHOULD BE RELATED TO LANGUAGE OF RELEVANT SECTIONS OF MINISTERIAL COMMUNIQUE WHICH WILL BE AVAILABLE IN DRAFT AT TIME OF EPC.) OTHER TOPICS (TO BE ELABORATED SEPTELS) INCLUDE DISCUSSION OF WP-2 CHAIRMAN'S REPORT AND POSSIBLE DISCUSSION OF STATE-OF-PLAY ON POSITIVE ADJUSTMENT POLICIES PAPER FOR MINISTERIAL. PRECISE LANGUAGE WHICH WILL MORE FULLY DESCRIBE TECHNICALITIES OF SCENARIO STILL BEING WORKED OUT WITH SECRETARIAT AND WILL BE SENT BY SEPTEL FOR CHAIRMAN SCHULTZE'S APPROVAL BEFORE BEING CIRCULATED TO DELEGATIONS AS "CHAIRMAN'S NOTE".
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